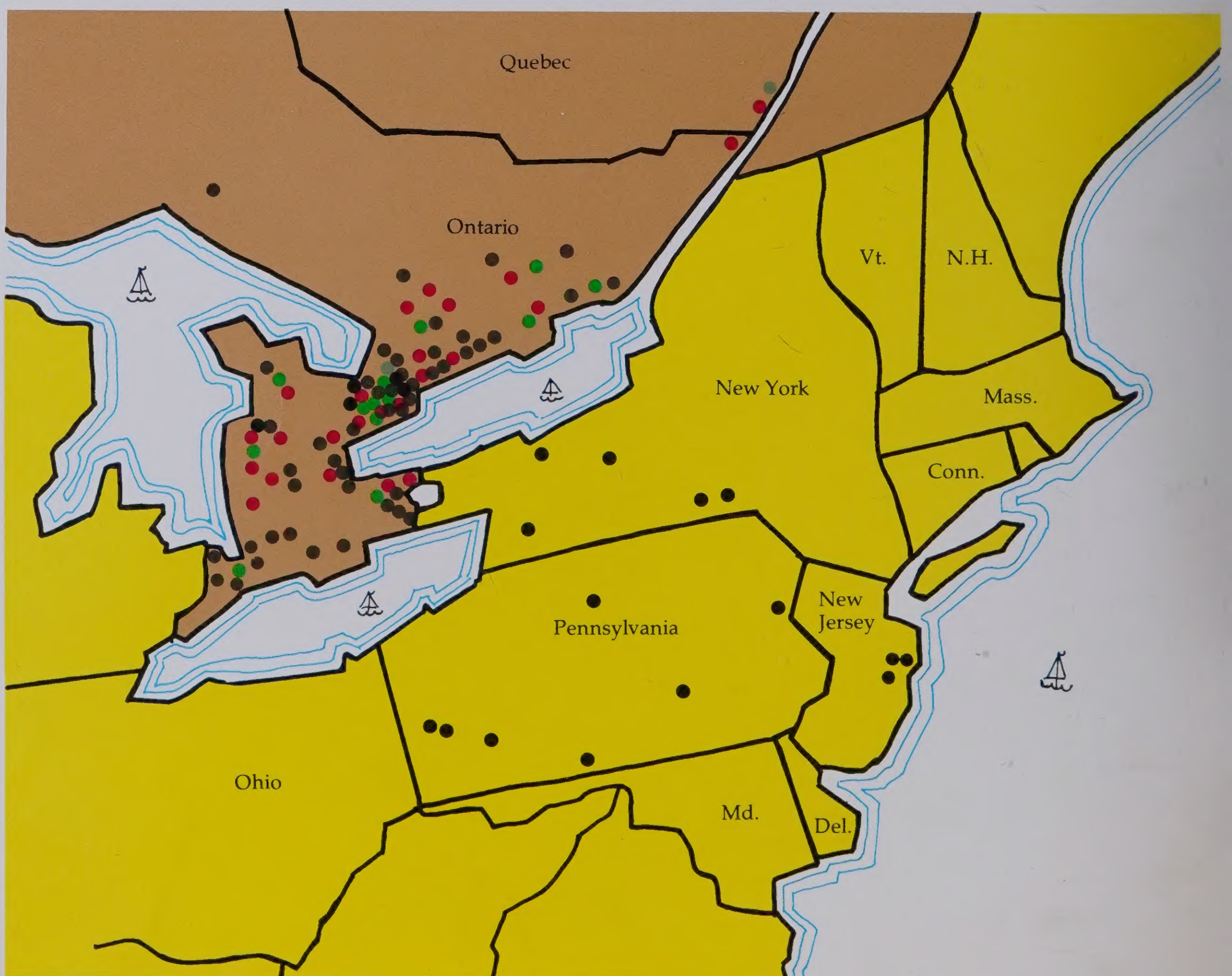
MDS Health Group Limited
Annual Report 1979

TEN YEARS OF GROWTH AND SERVICE


British Columbia
Alberta
Sask.
Manitoba
Ontario
Quebec
N.B.
N.S.
U.S.A.


Quebec
Ontario
Vt.
N.H.
New York
Mass.
Conn.
New Jersey
Pennsylvania
Ohio
Md.
Del.

MDS: What it is, where it is and what it does

MDS Health Group Limited is a Canadian company operating in both Canada and the United States and offering a range of services primarily within the health care field.

The principal business of MDS is a network of laboratories providing diagnostic clinical testing services to physicians, hospitals, convalescent institutions, veterinarians and industry in both Canada and the United States.

In addition, the company manufactures diagnostic reagents and micro-biological media; services diagnostic equipment; participates in the planning and development of physician-owned medical buildings and facilities; provides preventive and occupational health programs to business and industry; distributes both scientific and non-scientific products to laboratories, health care institutions and other users; and recently has begun to operate centres for the diagnosis and treatment of children with learning disabilities.

MDS believes in a decentralized regional approach with strong central co-ordination, a business style that respects the individual but not at the expense of the common objective; a business climate that encourages employees to develop their capacities so as to provide physicians, hospitals, patients and others with a professional service of the highest calibre.

Legend

Laboratory Division
Community Laboratories established before 1977
Community Laboratories established during and after 1977

Supply Division
Distribution Warehouses

Health Care Services Division
Clinics and Paramedical Insurance Outlets

Professional Services Division
Communities in which there is a completed MDS medical building project

Tomatis Centres
Communities with a Tomatis Centre

To our Shareholders

With the fiscal year which ended October 31, 1979, MDS Health Group Limited completed its first decade of operation. Year ten, like the company's first nine years, was a period of progress. The primary growth area continued to be our principal service, clinical laboratory testing, but there was also expansion into new and related fields. The momentum achieved in 1979 will continue into 1980, with emphasis on the consolidation and integration of the growth achieved in the last two years.

Earnings per common share before extraordinary item, increased 23% from $1.28 to $1.58. Net income for the year before extraordinary item, rose by 7%. This income growth rate, substantially lower than the 89% achieved in fiscal 1978, reflects significant costs paid out of current revenue for the start-up and expansion of the clinical laboratory business in the United States; the launching of a new division to help children with learning disabilities; higher interest rates; and delays in the consolidation of the clinical laboratory supply operations.

In the Province of Ontario, where MDS has the largest part of its laboratory operations, the role of private laboratories in the province's health care system achieved a broader acceptance by both the government and the health care community. As a consequence, the company's Ontario laboratory operations continued to grow.

In the United States, where laboratory operations were started by the company in late 1977, there was further growth both by acquisition and by new investment and expansion. In fiscal 1979 a total of six laboratories were added to the already existing network in New York and Pennsylvania. Two locations were established to serve physicians in the adjoining state of New Jersey and a regional reference laboratory was opened at Holmdel, New Jersey. A program of acquisition and start-up of new laboratories is under way in the 1980 fiscal year to increase MDS' penetration of existing market areas.

On September 28, 1979, MDS issued 74,749 common shares in exchange for the remaining 50% holdings of Biozyme Laboratories, Inc., of Olean, New York. MDS now holds 100% of Biozyme.

On October 30, 1979, MDS purchased the 49% minority shareholding in National Scientific Products Corporation as a further step in the consolidation of Supply Division operations. While the integration of the clinical laboratory supply operations of Colonial Scientific, Otto C. Watzka and Cenco is taking somewhat longer to achieve than had been anticipated, operating results for the Supply Division are expected to improve in 1980 and to achieve targeted levels thereafter.

Results for MDS Health Care Services Division improved in 1979, compared with those for the previous year, and this is expected to continue in fiscal 1980 through growth in both paramedical examinations for life insurance policy applications and health assessments for corporate employees. MDS Professional Services Division, which was established to organize and supervise health care building projects, showed a decline in activity, reflecting economic uncertainties and high interest rates which held up investment decisions by physicians and dentists who normally participate in such projects.

Since October 1978, MDS has been working with Dr. Alfred A. Tomatis in the evaluation of the Tomatis Method for the diagnosis and treatment of children with learning disabilities. A centre under Dr. Tomatis' direction was established in Scarborough at that time. A second centre was opened in the west end of Toronto in July, 1979 and additional centres are planned for fiscal 1980. In this the International Year of the Child, we were pleased to be able to participate in a program that will assist children to overcome a common and serious handicap and to live a fuller life.

On October 31, 1979, the company finalized arrangements on a ten million dollar loan repayable over twenty years. This loan will eliminate substantially all of the former long term debt and leave four million dollars for further expansion activities.

In March 1979 the Board of Directors approved an increase in the dividend on common shares to an annual rate of thirty cents per share.

The Board of Directors express their appreciation to the employees and medical consultants for their dedicated and effective efforts over the last year. The company's continued growth in revenues and earnings directly reflects their valuable contribution.

W. G. Lewitt
President

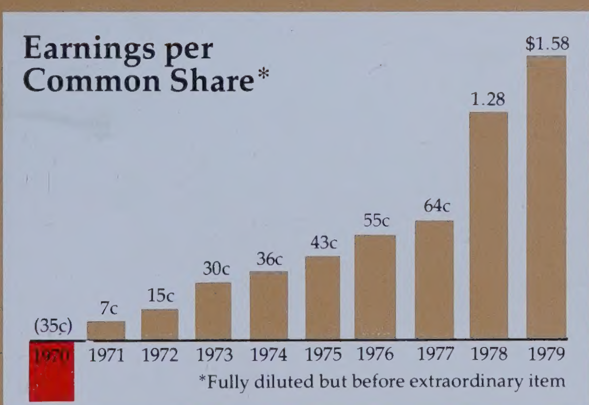
January 26, 1980

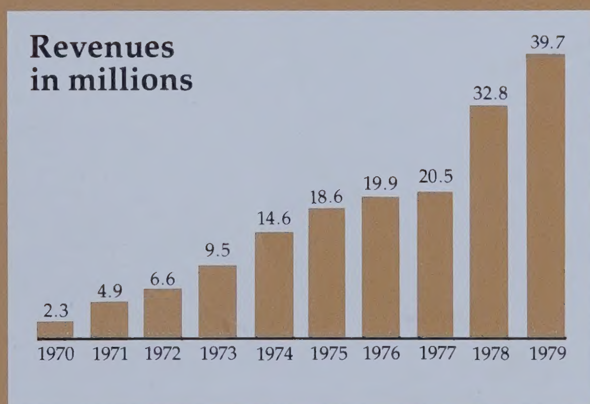
1979 Financial highlights

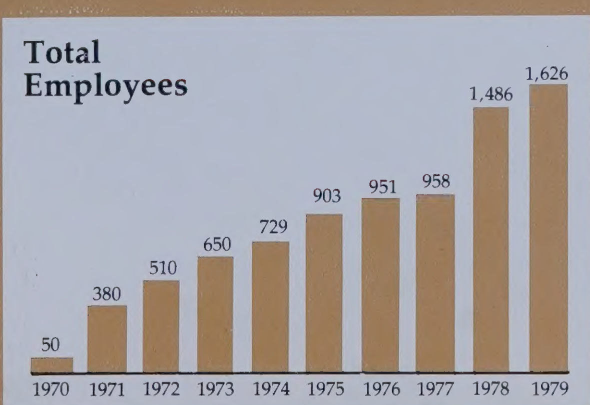
The year in review	1979	1978	% Change
Revenues	$39,698,000	$32,820,000	+ 21.0%
Depreciation and amortization	1,008,000	748,000	+ 34.8%
Income taxes	2,334,000	2,250,000	+ 3.7%
Income before extraordinary item	2,240,000	2,085,000	+ 7.4%
Earnings per common share*	$ 1.58	$ 1.28	+ 23.4%
Total assets employed	28,334,000	21,415,000	+ 32.3%
Shareholders' equity	9,531,000	6,677,000	+ 42.7%
Dividends paid per common share	$ .30	$ .15	+100.0%

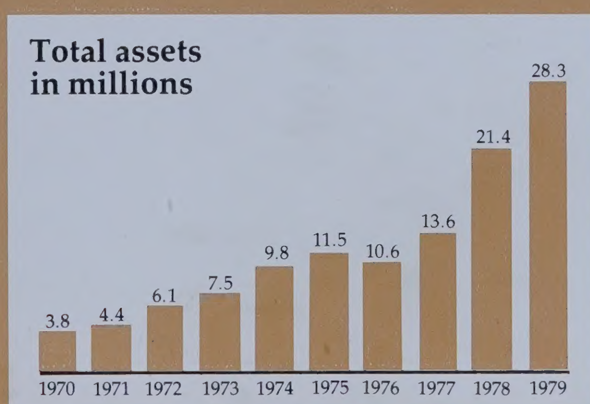
*Fully diluted but before extraordinary item

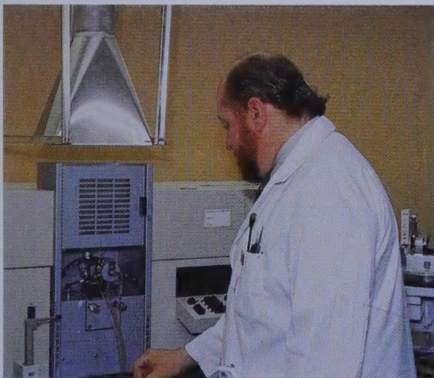
A ten year record of growth: 1970 - 1979

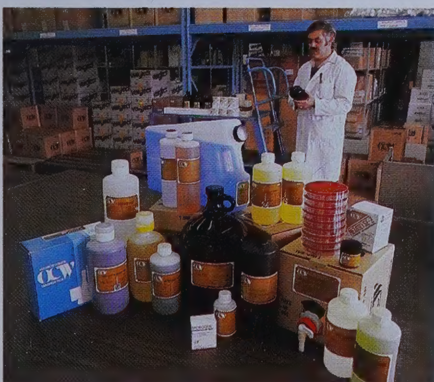


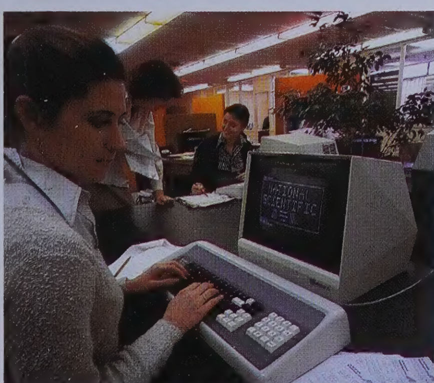












MDS Growth: Balance is the Key

MDS, in its first decade, has made steady progress by a balanced approach: sound planning combined with responsible financing and investment; scientific capability combined with business efficiency; internal growth combined with compatible acquisition; expansion of existing services combined with integration of, and diversification into, activities which are directly or indirectly related. The result has been maximum use of the company's managerial and operational strengths and of its physical and financial assets.

Growth By Extension of Existing Services

In Ontario, the number of physicians making use of MDS laboratory services has been growing steadily. This growth is based chiefly on the laboratories' reputation for high technical quality, for promptness and for responsiveness to the specific needs of both the medical profession and patients. MDS has been in the vanguard of innovation as new techniques and new opportunities for service have become available.

The extension of laboratory operations into New York State and Pennsylvania in 1977, and into New Jersey in 1979, has demonstrated the ability of the company to adapt its techniques to new and different areas and requirements. This adaptation and successful growth in the United States has resulted in large measure from the ability and effort of management and staff at all levels, a large number of whom were previously involved in the operation of the laboratories acquired by MDS as part of the U.S. expansion.

A new reference service for toxicology and other highly specialized procedures was introduced by MDS in 1979. Utilizing some of the most advanced equipment of its type in North America, MDS will continue to focus on new procedures and specialized markets for the further development of its service network.

Growth by Vertical Integration into the Manufacture of Products

Since MDS is a large consumer of diagnostic supplies and reagents, the company began in 1974 to manufacture many of these materials for its own use. By the end of 1979 this led into the external sale of a variety of reagents for automatic testing equipment. Preparations are now being made for the marketing of other manufactured products.

Growth by Diversification into New Fields of Activity

Distribution: In 1975 MDS diversified into the distribution business with the acquisition of Otto C. Watzka. In 1978 a new company, National Scientific, was formed through the merger of Otto C. Watzka and Cenco Canada Ltd. and operations were extended across Canada with the acquisition of the laboratory supply operations of Colonial Scientific in the Maritimes.

Tomatis Centres: In 1979 MDS established two centres utilizing the Tomatis Method to assist in overcoming problems of children with learning disabilities. It is estimated that in North America between 10 and 15 percent of all school children have learning disabilities, many of which are of types which have responded successfully to techniques developed by Dr. Alfred A. Tomatis of France. In working with Dr. Tomatis and establishing the Tomatis Centres, MDS is responding to a clear and significant need. While many elements of the operation of the centres are new to MDS, the skills and experience acquired in establishing and administering laboratories, including maintenance of standards and central control of multiple units in geographically separated areas, are applicable.

The Divisions in 1979 and the future

MDS Laboratory Divisions

MDS Laboratories is one of the largest providers of medical laboratory testing services in North America. Doctors utilize laboratory tests to assist in the diagnosis of disease and to monitor the results of treatment. More than 500 different testing procedures are performed by MDS Laboratories in Canada and the United States.

For the most part, private laboratories augment hospital resources. The many community locations provide convenience for patients and this, combined with highly efficient operating methods, means minimal demand on the time of the patient. Doctors receive results quickly to help speed diagnosis and subsequent treatment.

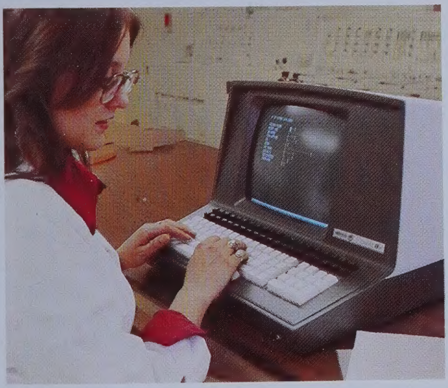
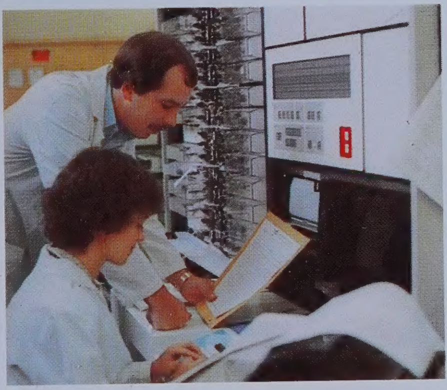
Private laboratories also specialize in certain types of testing or analysis, often requiring expensive technical equipment which some hospitals, particularly smaller ones, do not have. Further, they provide an additional service by sending technicians to collect specimens from patients who cannot come in for testing. This is of particular benefit to elderly patients in nursing homes or chronic care hospitals. Extensive courier services operated by the private laboratories deliver test specimens from rural areas and remote locations so that distance is far less a potential disadvantage in the care of patients.

MDS provides a total diagnostic laboratory service to more than 5,000 physicians and 300 hospitals in Canada and the United States. Physicians refer more than 2,000,000 patients or patient specimens to MDS centres annually. More than 100 company-employed drivers collect specimens from hospitals and institutions and service those physicians who are either not near an MDS patient centre or who prefer to obtain their own specimens. Fifty MDS home care nurses collect specimens from non-ambulatory patients. Some of the most sophisticated diagnostic equipment available is utilized by MDS Laboratories. Methods and quality control procedures to ensure reliable and meaningful results have been developed under the direction of a Medical Advisory Board. Each of MDS' 115 laboratories and patient centres is under the supervision of a medical director who is available on a consultant basis to discuss results with local medical practitioners or hospital pathologists.

Ontario Division: There are more than 275 private laboratories in Ontario. Their billings to the Government of Ontario represent approximately 2% of the Province's annual health care budget.

MDS, with a network of laboratories operating in more than fifty cities and towns, does more outpatient medical testing in the Province of Ontario than any other company. MDS is also a major reference laboratory resource for hospitals.

Physicians have the exclusive responsibility for ordering laboratory tests. In selecting a laboratory organization to help them serve their patients, doctors consider such factors as reliability of results, patient convenience, and speed of response — and they naturally place great emphasis on the

company's reputation, particularly for technical excellence. The number of physicians and hospitals selecting MDS as their laboratory continued to increase in 1979. The company expects greater utilization of its services in the future as a result of the introduction of new systems and procedures and the convenience of unique innovations like its specimen collection system, which is designed specifically to assist those physicians who are either not near an MDS patient centre or who prefer to take their own specimens.

U.S. Division: The clinical laboratory testing field is intensely competitive and highly fragmented in the United States. No single laboratory organization accounts for more than 1% of the total expenditures — estimated to be $14 billion in 1979 and growing at an annual rate of 15%.

There are approximately 6,000 independent or commercial laboratories, accounting for 25% of this expenditure. More than 7,000 hospital labs and 50,000 laboratories in physician offices account for the rest of the expenditures. An increasing number of physicians and hospitals are turning to more cost competitive and efficient independent laboratories for their testing needs as government and reimbursement agencies impose financial constraints to restrain burgeoning health care budgets.

Most major national firms follow a highly centralized, impersonal approach. MDS provides a locally-oriented service tailored to the needs of local physicians and patients, and because of its decentralization, delivers test results with the greatest possible promptness.

The operational philosophies and techniques that have been successful in Canada have been followed by MDS in establishing its full service regional laboratory network in the States of New York, Pennsylvania and New Jersey. In 1979 MDS acquired two additional laboratories and started up facilities in six new communities.

MDS broadened its breadth of services in 1979 by expanding into specialized markets such as emergency toxicology services. The specialized testing capability of the MDS network of laboratories is increasingly utilized by hospitals and other private laboratories outside of MDS' principal service area.

The response of clinicians and pathologists to the MDS approach has been most encouraging and the company is confident of continued growth in the United States.

Research and Development

In 1978 and 1979, under a contract with the National Research Council, MDS developed an easy to use and reliable diagnostic reagent for the detection of gonorrhea. MDS holds the exclusive rights and licence for the manufacture and sale of these reagents and expects initial sales to develop in 1980. MDS has organized to sell these products through its own resources in Canada and is in the process of negotiating an agreement for international distribution.

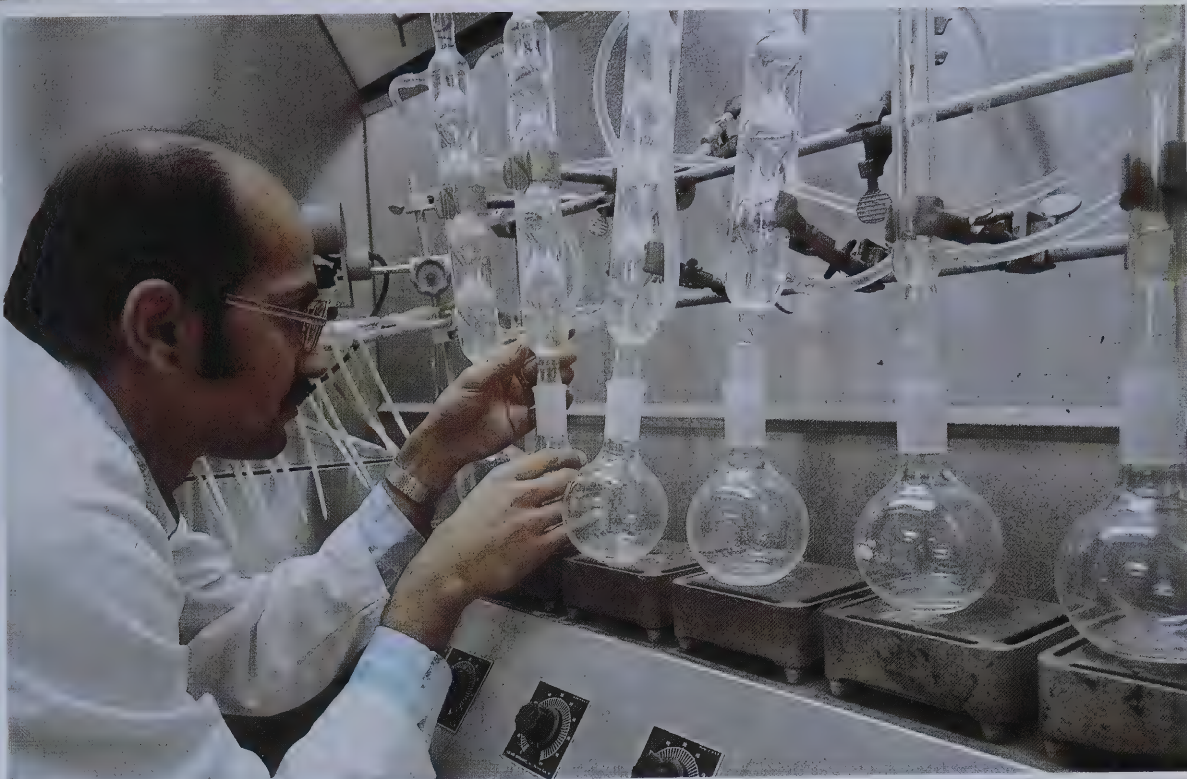
Two new research contracts were entered into in 1979 with the National Research Council of Canada, again directed to the development of innovative diagnostic procedures. One project is aimed at developing other products which could be sold to both the physician and laboratory markets as aids in diagnosing gonorrhea. The second contract is concerned with the development of simple immunochemical techniques for the detection of sexually-transmitted Chlamydial disease, a condition which is presently difficult to diagnose but is very common in some countries, and more prevalent than gonorrhea in North America.

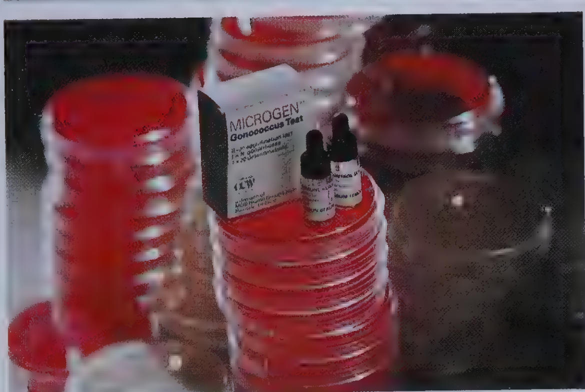
MDS Supplies Division

The manufacture, purchase and distribution of products for MDS Laboratories is carried out by OCW Diagnostics, part of the Supplies Division. Manufactured products include reagents for automated equipment and prepared culture media for microbiological testing. OCW also offers a program of preventive maintenance for automated hematology equipment. Many hospitals have contracted for this service.

National Scientific, a division of MDS Health Group Limited provides a coast-to-coast distribution capability from a computerized warehouse facility in Mississauga. The clinical, industrial and educational markets across Canada are serviced through branch offices tied into the master computer system.

During 1979, National Scientific became the exclusive distributor for an increasing number of clinical laboratory product lines. In addition, National Scientific began introducing its own privately labelled brand of products for high volume items used in the clinical laboratory. During the next few years emphasis will continue to be placed on growth through the merchandising of both exclusive and privately branded product lines.




MICROGEN
Gonococcus Test

MDS Health Care Services Division

Health Care Service clinics in Toronto and Montreal provide a wide range of health assessment programs for the employees of over 700 companies and carry out more than 60,000 paramedical exams on policy applicants for the Canadian insurance industry.

In addition, an occupational health clinic located in an industrialized area in western Toronto, provides both treatment and consultative services to approximately 350 companies located in this area.

Steps taken in 1978 to both broaden the breadth of services being offered and to expand the capability to conduct paramedical exams of life insurance policy applicants across Canada resulted in improved growth and performance of the Division in fiscal 1979. This momentum is expected to carry into 1980.

MDS Professional Services Division

MDS Professional Services specializes in developing medical/dental office buildings. MDS works with physicians and dentists to establish comprehensive health care buildings which are normally fully owned by the practitioner-tenants.

Several projects that had been expected to come to fruition in 1979 were delayed because of economic uncertainty and high interest rates and, in a few cases, by the unavailability of a suitable building site.

Tomatis Centres: A new direction

The terms dyslexic, perceptually handicapped, slow learner, are being encountered with increasing frequency in modern society. To parents everywhere the words, simple in themselves, conjure a poignant and all too familiar picture — children who seem emotionally and socially maladjusted, children who cannot "keep up with" their peers, children who live with frustration, unachieved potential, failure. And for every such child there is a family carrying its own share of what is often a heavy, costly and disruptive burden.

With increasing recognition of the problem and its adverse ramifications, major research efforts utilizing a formidable array of approaches have been mounted both here and abroad by dedicated workers in the field.

From among these the name of Dr. Alfred A. Tomatis has emerged to become increasingly familiar to all who have an interest in the subject. Over the past two decades the Tomatis Method has achieved widespread recognition in specialized clinics and educational institutions of all types in much of Europe.

Since October of 1978 MDS has been working with Dr. Tomatis and evaluating the Tomatis Method for the diagnosis and treatment of children with learning disabilities. A centre under Dr. Tomatis' professional direction was established in Scarborough at that time and is now fully operational. A second centre was opened in the west end of Toronto in July 1979 and plans are underway to open a number of additional centres both in Canada and the United States in 1980.

In addition to these activities, ongoing internal and external scientific research projects are being developed to further evaluate the Tomatis Method.

While the theory behind the Tomatis Method is complex and the techniques employed have been developed over many years, the fundamental approach is startlingly simple. Essentially it relates to the observation that some children, at an early stage of their development, lose or subconsciously turn off their ability to listen to certain parts of the normal sound spectrum. They do not effectively absorb, comprehend and interpret. Their limited receptiveness to the spoken word is reflected in confusion and in failure to read comprehensively and to write coherently. The basic communication tools instrumental to family life, social relationships and educational progress are, in a real sense, lost to them.

Yet the failure to listen is not the same as an inability to hear. It can usually be corrected. It involves listening training, using sensitive and specifically designed electronic equipment to increase the child's range of perception.

Various North American and European studies have estimated that between 10 and 15 percent of all children in the five to fourteen age bracket have a learning disability but that only a small percentage are currently being served by existing private and public institutions.

Based upon the beneficial changes experienced by children to date, it would appear that by making the Tomatis Method available on a broader scale, MDS will be able to assist children, adolescents, and adults to live a fuller life.





MDS Health Group Limited

(Incorporated under the Canada Business Corporations Act)

Responsibility for Financial Statements

Management

The accompanying consolidated financial statements of MDS Health Group Limited have been prepared by management in accordance with generally accepted accounting principles consistently applied. The most significant of these accounting principles have been set out in note 1 to the financial statements. These statements are presented on the accrual basis of accounting and, accordingly, a precise determination of many assets and liabilities is dependent upon future events which necessarily involves the use of estimates and approximations which have been made using careful judgement. In recognizing that the company is responsible for both the integrity and objectivity of the financial statements, management is satisfied that these financial statements have been prepared with this in mind and within reasonable limits of materiality.

The Board of Directors has appointed an Audit Committee consisting of non-management directors. The committee meets periodically during the year to review with management and the auditors any significant accounting and auditing matters and to review and finalize the annual financial statements of the company along with the independent auditors' report prior to the submission of the financial statements to the Board of Directors for final approval. The Audit Committee also reviews any major weaknesses in the company's system of internal control reported by the auditors.

The financial information throughout the text of this Annual Report is consistent with the information presented in the financial statements.

The company's accounting procedures and related systems of internal control are designed to provide reasonable assurance that its assets are safeguarded and its financial records are reliable.

External Auditors

The auditors' opinion is based upon an independent and objective examination of the company's financial results for the year conducted in accordance with generally accepted auditing standards. This examination includes an understanding and evaluation by the auditors of the company's accounting system and internal control procedures as well as obtaining a sound understanding of the company's business. The external auditors conduct appropriate tests of the company's transactions and obtain sufficient audit evidence in order to provide them with reasonable assurance that the financial statements are presented fairly in accordance with generally accepted accounting principles thus enabling them to issue their report to the shareholders.

Clarkson Gordon, Chartered Accountants, having been appointed by the shareholders of the company to serve as the company's external auditors, have examined the consolidated financial statements of the company for the year ended October 31, 1979 and have reported thereon in their report set out below which is dated January 4, 1980.

Auditors' Report

To the Shareholders of
MDS HEALTH GROUP LIMITED:

We have examined the consolidated balance sheet of MDS Health Group Limited as at October 31, 1979 and the consolidated statements of income, retained earnings and changes in financial position for the year then ended. Our examination of the financial statements of MDS Health Group Limited and those subsidiaries of which we are the auditors was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances. We have relied on the report of the auditors who have examined the financial statements of National Scientific Products Corporation Limited.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at October 31, 1979 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

CLARKSON GORDON
Chartered Accountants

Mississauga, Canada
January 4, 1980.

Consolidated Financial Statements

Year ended October 31, 1979

Consolidated Statement of Income

Year Ended October 31, 1979 (with comparative figures for 1978)

	1979	1978
Revenues, net of discounts	$ 39,698,000	$32,820,000
Operating costs before the following:	33,259,000	27,130,000
Depreciation and amortization	1,008,000	748,000
Interest expense — long-term debt	892,000	608,000
— other (net)	164,000	147,000
Foreign exchange loss (gain)	81,000	(50,000)
	35,404,000	28,583,000
Income before income taxes, minority interest and extraordinary item	4,294,000	4,237,000
Provision for income taxes	2,334,000	2,250,000
Income before minority interest and extraordinary item	1,960,000	1,987,000
Minority interest share of loss	280,000	98,000
Income for the year before extraordinary item	2,240,000	2,085,000
Extraordinary item:		
Loss on sale of a Quebec division (note 7)	114,000	
Net income for the year	$ 2,126,000	$ 2,085,000
Earnings per common share before extraordinary item:		
Basic	$1.71	$1.33
Fully diluted	$1.58	$1.28
Earnings per common share for year:		
Basic	$1.62	$1.33
Fully diluted	$1.50	$1.28

(See accompanying notes)

Consolidated Statement of Retained Earnings

Year Ended October 31, 1979 (with comparative figures for 1978)

	1979	1978
Retained earnings, beginning of year:		
As previously reported	$ 3,954,000	$ 3,277,000
Adjustment of prior years' income (note 11(a))	(161,000)	(188,000)
As restated	3,793,000	3,089,000
Net income for the year	2,126,000	2,085,000
Excess of cost over paid-up capital of common shares purchased		(1,169,000)
Dividends paid during the year:		
Class A ($0.40 per share in 1979 and 1978)	(57,000)	(20,000)
Common shares ($0.30 per share in 1979 and $0.15 per share in 1978)	(392,000)	(192,000)
Retained earnings, end of year	$ 5,470,000	$ 3,793,000

(See accompanying notes)

Consolidated Balance Sheet

October 31, 1979 (with comparative figures for 1978)

Assets

	1979	1978
Current assets:		
Cash and short term investments	$ 4,155,000	$ 1,344,000
Accounts receivable (note 2)	8,182,000	7,163,000
Inventory, at lower of cost and net realizable value (note 2)	3,632,000	3,087,000
Future income tax reductions	631,000	227,000
Prepaid expenses	556,000	489,000
Current deferred income taxes	45,000	74,000
	17,201,000	12,384,000
Long term investments, at cost less allowance for doubtful realization:		
Debenture and notes receivable	139,000	94,000
Investment in shares of and advances to other companies	411,000	368,000
	550,000	462,000
Fixed assets (notes 2 and 3)	4,718,000	3,470,000
Non-current assets (note 4)	250,000	205,000
Excess of amounts paid over the fair value of the net tangible assets acquired on the purchases of shares and assets, less amortization and write-off	5,615,000	4,894,000
	$28,334,000	$21,415,000

On behalf of the Board:

Director

Director

Liabilities and Shareholders' Equity

	1979	1978
Current liabilities:		
Bank indebtedness (note 2)	$ 1,323,000	$ 2,037,000
Accounts payable and accrued liabilities	3,851,000	3,272,000
Current portion of long term debt (note 2)	503,000	961,000
Income and other taxes payable	2,644,000	1,089,000
	8,321,000	7,359,000
Long term debt (note 2)	10,321,000	6,673,000
Deferred income taxes	161,000	15,000
Minority interest (note 6)		691,000
Shareholders' equity:		
Capital stock (note 5)–		
Authorized:		
An unlimited number of 8% convertible, cumulative Class A shares, redeemable at a value of $5 per share		
100 Class B redeemable non-voting preferred shares		
An unlimited number of common shares		
Issued:		
142,046 Class A shares	710,000	710,000
100 Class B shares	411,000	
1,344,039 common shares (1,269,290 in 1978)	2,940,000	2,174,000
	4,061,000	2,884,000
Retained earnings	5,470,000	3,793,000
	9,531,000	6,677,000
	$28,334,000	$21,415,000

(See accompanying notes)

Consolidated Statement of Changes in Financial Position

Year Ended October 31, 1979 (with comparative figures for 1978)

	1979	1978
Funds were provided from:		
Operations —		
Income before minority interest and extraordinary item	$ 1,960,000	$ 1,987,000
Add charges not requiring an outlay of working capital:		
Depreciation and amortization	938,000	674,000
Amortization of goodwill	70,000	74,000
Deferred income taxes	125,000	6,000
Amortization of deferred foreign exchange loss	70,000	
Provision for doubtful realization of long term investments	30,000	
Funds provided from operations	3,193,000	2,741,000
Long term debt less $5,950,000 retired in 1979	4,050,000	1,000,000
Proceeds on disposal of non-current assets of the Quebec laboratory division net of long term receivable of $50,000	89,000	
Investment in 51% owned subsidiary —		
Funds increased by long term debt and minority interest less the cost of non-current assets		2,343,000
Issue of Class A shares		500,000
Repayment of loan to deferred profit sharing plan		358,000
Decrease in other assets	11,000	139,000
Issue of common shares		67,000
Total funds provided	7,343,000	7,148,000
Funds were applied to:		
Investment in subsidiaries (less working capital and fixed assets acquired and minority interest in 1978)	1,402,000	922,000
Minority interest		25,000
		897,000
Long term debt of acquired companies		657,000
	1,402,000	240,000
Less portion of purchase price satisfied with the issue of — common shares	766,000	
— Class B shares	411,000	
— long term debt		332,000
	225,000	(92,000)
Purchase fixed assets	2,214,000	1,940,000
Reduce long term debt over one year	402,000	829,000
Pay dividends on common shares	392,000	192,000
Pay dividends on Class A shares	57,000	20,000
Debt issue expense	125,000	10,000
Long term investments — advances	73,000	
Purchase shares for cancellation		1,949,000
Deferred foreign exchange loss		110,000
Total funds applied	3,488,000	4,958,000
Increase in working capital	3,855,000	2,190,000
Working capital, beginning of year	5,025,000	2,835,000
Working capital, end of year	$ 8,880,000	$ 5,025,000
Represented by:		
Current assets	$17,201,000	$12,384,000
Current liabilities	8,321,000	7,359,000
	$ 8,880,000	$ 5,025,000

(See accompanying notes)

Notes to Consolidated Financial Statements

October 31, 1979

1. Accounting policies

The company follows generally accepted accounting principles, the most significant of which are as follows:

(a) Basis of consolidation —
The accounts of all subsidiaries are consolidated on a purchase basis from the date of acquisition.

(b) Fixed assets —
Fixed assets are carried in the accounts at cost. Gains or losses arising on the disposal of individual assets are recognized in income in the year of disposal.

Depreciation is generally provided on a straight-line basis over the estimated useful lives of assets at annual rates as follows:

Buildings	— 4%
Major equipment	— 20%
Other equipment, furniture and fixtures	— 10%
Leasehold improvements	— Lesser of 10% or the length of the lease plus one renewal option

(c) Inventories —
Inventories are valued at the lower of cost, determined on a first-in, first-out basis, and net realizable value.

(d) Development and start-up costs —
Costs associated with development of new products and locations and with the acquisition of new business are expensed as incurred.

(e) Amortization of intangibles —
For acquisitions after March 31, 1974, the excess of amounts paid over the fair value of the net tangible assets (also referred to as goodwill in these financial statements) acquired on the purchase of shares and assets is capitalized and is being amortized over periods not exceeding forty years. For acquisitions prior to April 1, 1974 the excess has been capitalized and no amounts are being amortized.

(f) Debt issue expense —
Debt issue expense is amortized over the term of the debt.

(g) Developments —
In prior years, the company had made investments in building projects. At the year end, these investments have been recorded as non-current assets at cost less allowance for doubtful realization in the company's financial statements. When there is reasonable expectation of realizing the present holdings within the next fiscal year, such holdings will be reclassified as current assets. It is not the company's intention to continue to make long term investments in new building projects.

(h) Income taxes —
The company follows the deferral method of income tax allocation. Deferred income taxes result from claiming deductions for tax purposes in excess of amounts charged in the accounts. Where the company is virtually certain of realizing a future income tax reduction from a loss carry forward for tax purposes, the future income tax reduction is recognized in the accounts in the current year.

(i) Exchange translation —
The statements of companies whose accounts are maintained in U.S. dollars have been translated into Canadian dollars substantially as follows: inventories, fixed assets, goodwill, deferred income taxes and related expenses, at historic rates of exchange; all other assets and liabilities, at exchange rates prevailing at the end of the year; income and expenses (other than those related to assets and liabilities translated at historic rates) at average rates for the year. Translation gains or losses are included in income except unrealized losses on long term debt which are deferred and charged to income over the unexpired term of the debt.

(j) Earnings per common share —
Earnings per common share have been calculated using the weighted monthly average number of shares outstanding during the year. Fully diluted earnings per common share have been calculated on the assumption that all the Class A shares outstanding at the year end had been converted to common shares at the beginning of the year.

Notes (continued)

2. Long term debt

	Maturity	Payable within one year	Total 1979	Total 1978
Canadian operations:				
1979 Debentures	1999	$112,000	$10,000,000	
Other notes and mortgages (interest varies from 8% to 12¹/₄%)	1980-1998	205,000	542,000	$ 702,000
Bank loans and Series A & B debentures retired in 1979				6,020,000
		317,000	10,542,000	6,722,000
U.S. operations (converted into Canadian dollar equivalent):				
Other notes and mortgages payable (interest varies from 6% to 9³/₄%)	1981-1986	186,000	282,000	312,000
Bank loans retired in 1979				600,000
		186,000	282,000	912,000
Sub total		$503,000	10,824,000	7,634,000
Less payable within one year			503,000	961,000
Total			$10,321,000	$6,673,000

On October 31, 1979 the company issued debentures for $10,000,000, the funds being used to repay all existing bank loans and debentures and to increase working capital. The new debentures bear interest at a fixed rate of 13% for the first two years and thereafter at a floating rate of 1³/₈% over the prime rate (with a minimum rate of 10% and a maximum rate of 13¹/₄%). The debentures are repayable in monthly payments of principal and interest over a twenty year period.

The 1979 debentures have been collateralized by a fixed and floating charge debenture issued by the parent company and its U.S. subsidiary. Under the terms of the debenture the company may pledge its accounts receivable and inventory as security for short term bank borrowings as long as total bank borrowings are at least $1,000,000 less than the book value of current assets.

In addition to the 1979 debentures, the company has an operating line of credit of $6,000,000 with a Canadian chartered bank for which a specific charge on accounts receivable and inventory has been given. At October 31, 1979, $819,000 has been advanced to the company as a demand loan in connection with this line of credit.

Certain fixed assets have been pledged as collateral against approximately $200,000 of the other notes and mortgages.

Principal repayments required in the next five fiscal years are:

1980 — $503,000
1981 — 191,000
1982 — 253,000
1983 — 328,000
1984 — 241,000

At October 31, 1979, the company had satisfied all covenants under the trust deed relating to the debentures.

3. Fixed assets

	1979 Cost	1979 Accumulated depreciation and amortization	1979 Net	1978 Net
Land	$ 41,000		$ 41,000	$ 36,000
Buildings	301,000	$ 34,000	267,000	234,000
Equipment and furniture	6,222,000	2,750,000	3,472,000	2,488,000
Leasehold improvements	2,092,000	1,154,000	938,000	712,000
	$8,656,000	$3,938,000	$4,718,000	$3,470,000

4. Non-current assets

	1979	1978
Deferred foreign exchange loss less amortization	$ 40,000	$110,000
Debt issue expense less amortization	185,000	64,000
Other	25,000	31,000
	$250,000	$205,000

5. Capital stock

(a) Issue of common shares —

During the year, the company issued 74,749 common shares for a total consideration of $766,000 in connection with the purchase of the remaining interest in Biozyme Laboratories Inc. (note 6(a)).

(b) Issue of Class B shares —

At a special meeting of the shareholders on October 22, 1979 and by a Certificate of Amendment dated October 30, 1979, the company approved the creation of 100 Class B, redeemable non-voting preferred shares. These shares have special characteristics concerning redemption, the details of which have been set out in note 6(b).

On October 30, 1979, these Class B shares were issued for $411,000 in connection with the purchase of the remaining 49% interest in National Scientific Products Corporation Limited (note 6(b)).

(c) Other rights to acquire common shares —

Class A shares may be converted at any time on a one-for-one basis into common shares.

6. Acquisitions

(a) In 1979, the company acquired the remaining 50% interest in the common shares of Biozyme Laboratories Inc. for a total consideration of approximately $766,000 represented by the issuance of 74,749 common shares of MDS Health Group Limited. The total purchase price has been ascribed to goodwill.

(b) On October 30, 1979, the company acquired the remaining 49% of the common shares of National Scientific Products Corporation Limited ("National") in exchange for 100 Class B shares. The value ascribed to the Class B shares was $411,000 representing 49% of National's net book value to the parent company as at October 30, 1979. The redemption value of the Class B shares (which approximates $102,000 at October 31, 1979) will be determined by a formula involving both the net book value and any after-tax earnings of National. During the period November 1, 1983 to October 31, 1988, the company may redeem these shares or the holder of the Class B shares may require the company to redeem them. The option period for redemption of these shares can be extended by the company for an additional five years to October 31, 1993.

(c) In connection with certain previous acquisitions of medical laboratories in the United States the company entered into employment and consulting agreements that called for payments based on volumes of business. During the year an additional amount of $193,000 relating to these agreements has been accounted for as an additional cost of purchase.

7. Dispositions

During the year, the company disposed of its Quebec laboratory division. This sale resulted in an accounting loss of $103,000 plus income taxes in the amount of $11,000 primarily relating to goodwill sold. The resulting loss on this disposal has been reflected in the accompanying statement of income as an extraordinary item.

8. Income taxes

During 1979 and 1978 losses were incurred by certain subsidiaries, for which the future tax benefit has not been reflected in the accounts. This accounting treatment results in a high tax rate on accounting income of approximately 54% in 1979 and 53% in 1978.

Loss carry forwards, many of which arose prior to acquisitions, amount to $1,671,000 and expire as follows:
1982 – $85,000; 1983 – $295,000; 1984 – $310,000; 1985 – $499,000 and 1986 – $482,000. In addition, certain U.S. companies have unused investment tax credits of $135,000 available to reduce future income taxes payable which have not been recognized in the accounts. The major portion of these credits expire in the years 1984-1986.

9. Statutory information

At the close of business on October 31, 1979, the company and its wholly-owned subsidiary company, National Scientific Products Corporation Limited, amalgamated under the provisions of the Canada Business Corporations Act to form a new company with the same name MDS Health Group Limited. National Scientific will operate as a division of the company.

10. Commitments

(a) Under the premise, equipment and vehicle leases entered into by the company and its subsidiaries up to October 31, 1979, the company is obliged to make minimum payments of approximately $1,676,000 in 1980, $1,211,000 in 1981, $854,000 in 1982, $583,000 in 1983, $387,000 in 1984 and $1,080,000 thereafter.

(b) In order to establish a new division, the company has entered into certain royalty, consulting and exclusivity agreements calling for minimum payments of $138,000 in 1980, $188,000 in 1981 and $238,000 in 1982. In addition, if certain events occur prior to 1983 certain agreements will be extended to 1989 requiring minimum payments of $150,000 per year.

11. Contingent liabilities

(a) In 1977, the Ontario Ministry of Health issued reassessments to the company in connection with previous billings to the Ontario Health Insurance Plan (OHIP). If management is unsuccessful in its continuing discussions with OHIP to resolve such reassessments, $161,000 (net of applicable income taxes) would be repayable. This sum has been charged to retained earnings in 1979 as a prior period adjustment.

(b) A subsidiary has guaranteed a bank loan totalling $70,000 in connection with one of its real property development activities. As primary collateral for this bank loan, assets of the development project have been pledged.

A ten year financial summary

Years ended October 31 — Figures in thousands of dollars

	1979	1978	1977	1976	1975	1974	1973	1972	1971	1970
STATEMENT OF INCOME										
Net revenues	**39,698**	32,820	20,494	19,870	18,645	14,576	9,532	6,608	4,908	2,252
Income (loss) before extraordinary items	**2,240**	2,085	1,089	957	938	784	667	337	143	(652)
Net income (loss) for the year	**2,126**	2,085	1,089	995	938	382	586	624	351	(1,072)
BALANCE SHEET										
Working capital	**8,880**	5,025	2,835	912	1,514	1,208	1,134	687	113	(205)
Fixed assets (net)	**4,718**	3,470	2,053	2,144	2,139	1,728	977	750	567	574
Other assets (including goodwill)	**6,415**	5,561	5,063	3,895	3,646	3,618	3,703	3,122	2,749	2,561
Total assets	**28,334**	21,415	13,632	10,576	11,469	9,769	7,471	6,117	4,353	3,833
Long term debt	**10,321**	6,673	3,756	1,660	1,702	1,846	1,544	892	1,485	1,682
Shareholders' equity	**9,531**	6,677	6,186	5,269	5,527	4,600	4,234	3,667	1,944	1,248
SOURCE OF FUNDS (selected items)										
Working capital from operations	**3,193**	2,741	1,365	1,305	1,253	1,069	819	454	228	(540)
Issue of long term debt	**4,050**	1,000	2,540	600	—	425	700	—	—	799
Issue of common shares	**766**	67	1	4	6	1	66	1,000	—	—
Issue of Class A shares	**—**	500	—	—	—	—	—	—	275	—
Issue of Class B shares	**411**	—	—	—	—	—	—	—	—	—
APPLICATION OF FUNDS (selected items)										
Purchase of fixed assets	**2,214**	1,940	386	480	854	987	380	297	164	481
Investment in subsidiaries and divisions	**225**	(92)	227	(8)	—	351	335	140	4	460
Dividends on common shares	**392**	192	156	167	—	—	—	—	—	—
Dividends on Class A shares	**57**	20	17	17	17	17	19	22	—	—
Reduction in long term debt	**402**	829	443	792	144	204	248	603	203	18
Purchase of shares for cancellation	**—**	1,949	—	1,073	—	—	—	—	—	—
PER COMMON SHARE ($ per share)										
Earnings (loss) fully diluted and before extraordinary items	**1.58**	1.28	.64	.55	.43	.36	.30	.15	.07	(.35)
Earnings (loss) fully diluted and after extraordinary items	**1.50**	1.28	.64	.57	.43	.17	.26	.28	.19	(.57)
Number of shares outstanding at end of period (000's)										
Class A	**142**	142	42	42	42	42	42	55	55	—
Common	**1,344**	1,269	1,674	1,673	2,152	2,147	2,146	2,107	1,888	1,877

Directors and Officers

Board of Directors

°**Dr. W. Anderson**
Professor of Pathology, University of Toronto

†***J.W.L. Fordham**
Vice-President, Diamond Shamrock Corporation

†**A. Grieve**
Investment Consultant

°**Dr. L.R. Harnick**
Chief Radiologist, Toronto Western Hospital

***R. Horner**
Investment Consultant

†**W.G. Lewitt**
President, MDS Health Group Limited

R.M. Warren
Chief General Manager, Toronto Transit Commission

***R.D. Wilson, Q.C.**
Partner, Fasken & Calvin

R.H. Yamada
Vice-President, MDS Health Group Limited

†Executive Committee *Audit Committee
°Medical Advisory Committee

Officers and Corporate Management

W.G. Lewitt
President
Chief Executive Officer

J.E. Boyce
Vice-President
Organization Development & Personnel

D.M. Phillips
Vice-President
General Manager, MDS Laboratories

J.A. Rogers
Vice-President
Finance

E.K. Rygiel
Vice-President
Corporate Development

R.H. Yamada
Vice-President
General Manager, MDS Health Care Services

B.R. Moffatt
Corporate Secretary

Dr. W. Anderson
Chairman, Medical Advisory Board

Dr. J.C. Nixon
Medical Director, MDS Laboratories

Subsidiary Management

Dr. G.M. Cahilly
Vice-President
MDS Health Group Inc.

W.R. Snowden
President
National Scientific Products

Head Office

30 Meridian Road, Rexdale, Ontario M9W 4Z9
(416) 675-7661

Transfer Agents & Registrar

Guaranty Trust Company of Canada
Toronto-Montreal

Auditors

Clarkson Gordon

Legal Counsel

Fasken & Calvin

Stock Listing

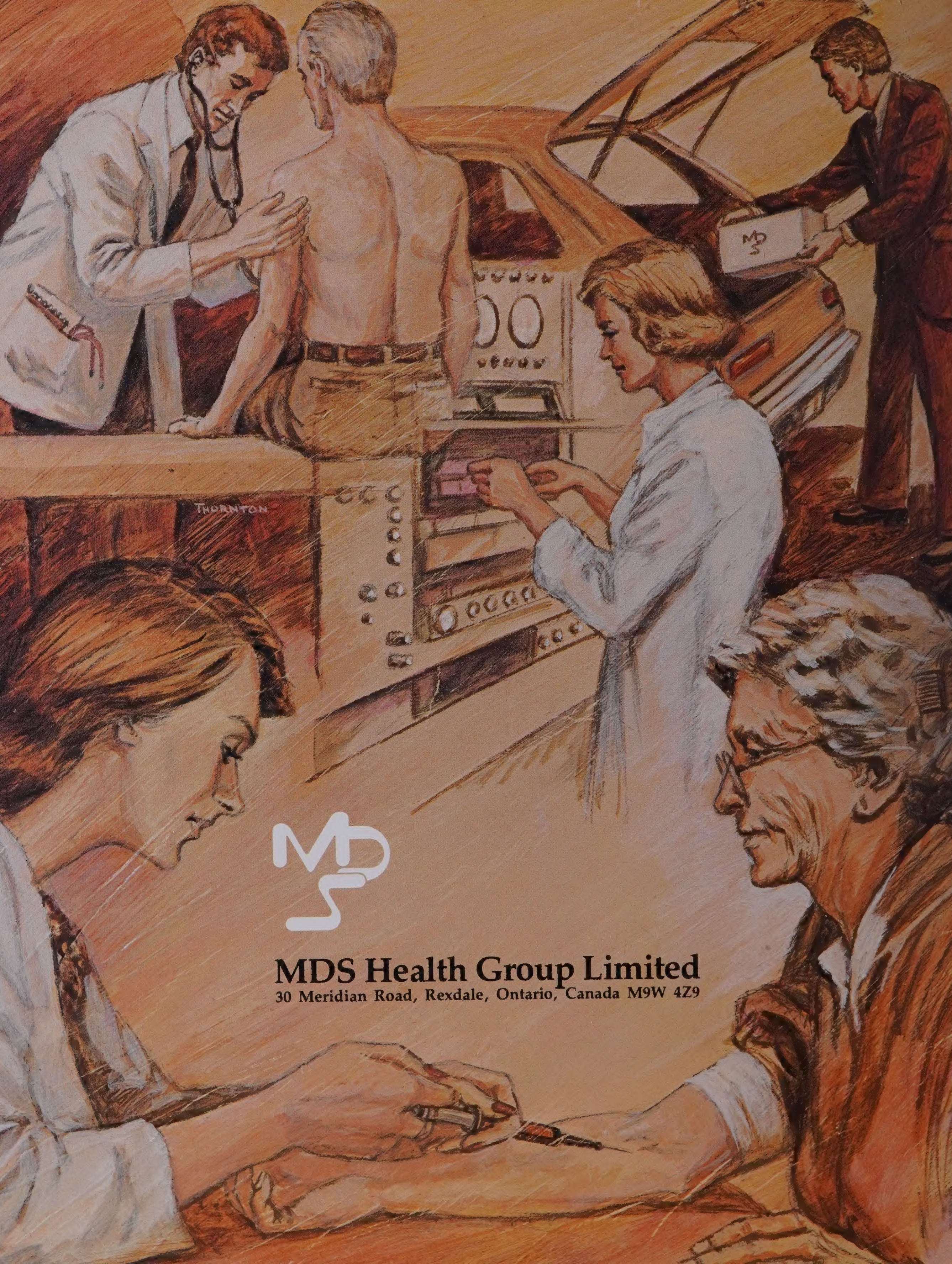
Toronto Stock Exchange
Symbol-MHG

Bankers

Canadian Imperial Bank of Commerce

Annual Meeting

Shareholders are invited to attend the company's ANNUAL AND SPECIAL MEETING at 4 p.m., March 13, 1980 in the Tudor Room of the Royal York Hotel, Toronto, Ontario.



MDS Health Group Limited
30 Meridian Road, Rexdale, Ontario, Canada M9W 4Z9